RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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January 25, 1984 **LETTER 879**

Jan. 13, DJIA 1270.10; PTI 1779; A-D Ratio –14.83
Jan. 20, DJIA 1259.11; PTI 1777; A-D Ratio –15.17

COMMENTS FOR 1984: By now all my subscribers should know that I believe this is a primary bull market. Theoretically, people should be able to make money in a primary bull market. But I'll tell you a secret–an awful lot of people lose money during bull markets. In fact, I strongly suspect that MOST people lose money during bull markets. How can this be? Easy, most people trade stocks or if they don't trade, they tend to buy high during bull market rallies and sell out near the bottom of the inevitable reactions.

Furthermore, I'd say that the odds on losing money in this particular bull market are better than ever.The reason is that the banks, the brokerage houses, the advisors and the major exchanges have all encouraged speculation. They've encouraged speculation in options, puts and calls, commodities, futures–and they are absolutely obsessed with market timing.

As far as options, commodities and puts and calls are concerned, I'm not even going to discuss them here. If you keep messing with these trading vehicles, it's just a matter of time before you'll lose your shirt. It seems as though the various exchanges come up with a new option or new future item about every week or so. They're not bringing out all these trading vehicles so you can get rich. No, they're bringing them out to generate commissions. So my advice to my own subscribers is to forget all those exciting trading vehicles. They constitute an almost sure way of you losing your money. The losses aren't guaranteed to occur, mind you, but they're pretty sure. You don't believe me? Try it!

Now we come to market timing. Most of today's brokers and advisors have never seen a real, long-term primary bull market. I'm not saying it's their fault. But they just weren't around during the 1940s or the 1950s, and therefore, they never saw the real McCoy. Consequently, they think today's bull market is just a repeat of the 1970s, only more so. But they're wrong.

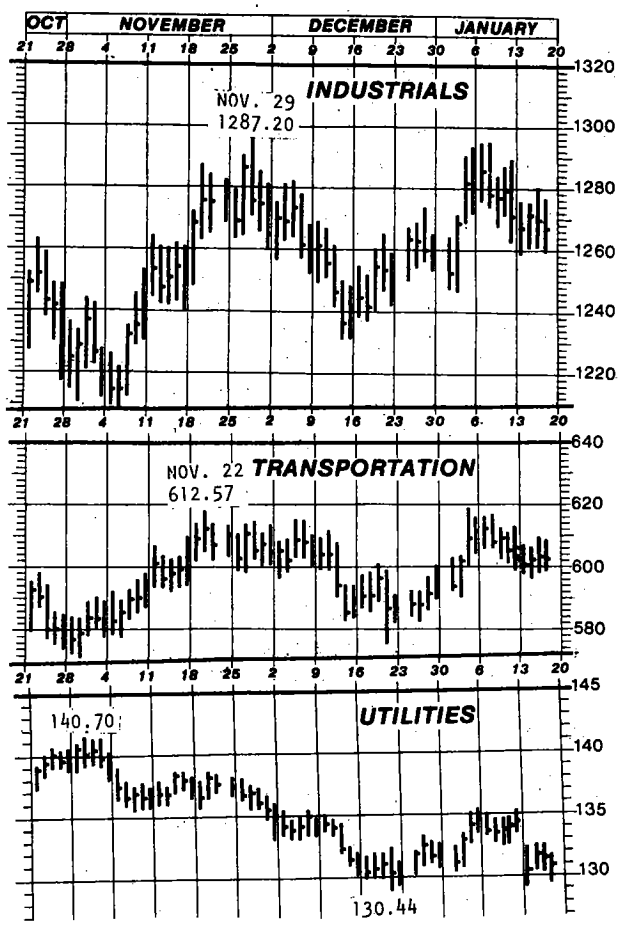
All during 1966 to 1983 we saw extreme volatility. The Dow would run up to 1000, then collapse down to 550 or 770 or 685. Then it would run up to 1000 again. It did that so many times that my friend Jim Dines termed the Dow 1000 level "the graveyard in the sky." And he was just about right.

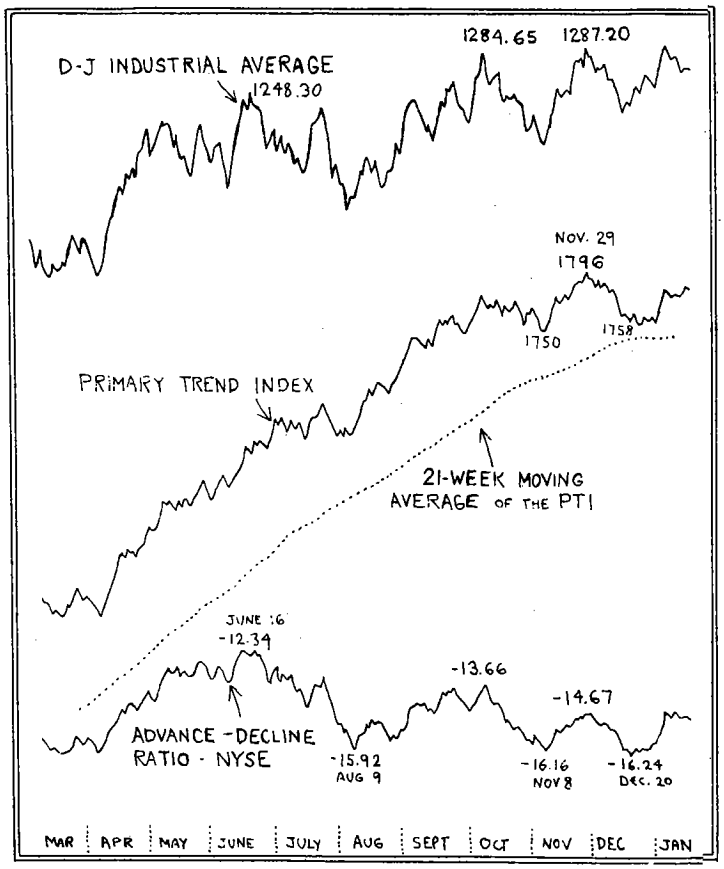
Then we witnessed the big move which started in August 1982. And we were in a real primary bull market. And as far as my studies are concerned, we're still in a primary bull market. But a strange thing has happened. Every stock market letter is talking about "the first five days of 1984" or "be 55% invested now, but be ready to go to 70% in a few months" or "be ready for a sharp two-week correction followed by a month of erratic rally." Suddenly, every guy with an advisory letter is a market timer, and they're telling you how to beat the market with foreign currencies, hot stocks, options, futures and up-dated daily charts.

So what does it all add up to? In my opinion, most of the advisories are looking in the wrong direction. They think it's still 1975. But this is 1984, and my advice is to ride the long-term primary trend. The easiest, surest and most convenient way to do this is with mutual funds. Let the professionals pick the stock for you, and you just stay with the primary trend.

The year 1983 was widely accepted as being one of the toughest and costliest for commodity traders in recent history. I would guess it was about the same for stock traders. One reason is that TOO MANY PEOPLE were (and are) trying to *beat the trend* through trading. The market (even a bull market) has a way of dealing with crowds. The way is simple–it wipes them out.

Here's another observation (or should I say intuition) I have for 1984. There are now 42 million stockholders in the US markets. This is far more than ever before. In other words, we've got a





lot of people trading or holding stocks today. We also have instant communications. In other words, if there's a dividend cut or a natural disaster or a corporate takeover, everyone in the country knows about it within ten minutes. This militates toward "crowd psychology" and toward buying panics and selling panics. What's a buying panic or a selling panic? It's everybody buying or selling AT THE SAME TIME. Mark my words, I expect to see many buying and selling panics as this bull market goes along. There are just too many people all tuned in to the same data, the same items (a typical example of what I am talking about is the action of the utilities on January 16 when the news of the Public Service of Indiana and Commonwealth Edison nuclear shutdowns hit the tape).

Furthermore, with the home computer rage going full blast, communications will be still faster in the future. And this will make for even more concerted crowd action. But although this may make the short-term action more erratic, it will not change or alter the primary or long-term trend of the market.

Therefore (unlike most other market advisors), I now suggest only the broadest kind of investment action. The single operative fact for me about the current market is that it is a primary bull market. This kind of bull market doesn't go straight up, it doesn't follow your rules or my hopes, it doesn't have to conform to the well-known Presidential four-year cycle or the widely publicized Kondratieff Wave. Remember, what everyone knows about Wall Street ceases to be a factor (or at least it becomes a minimum factor). Thus, I continue to believe the one thing that no one is convinced of – that this is a bull market and the bull will dominate during the period ahead.

My Primary Trend Index has stood us in good stead as far as staying on the right side of the market. I intend to place just as much emphasis on the PTI as we go along in this remarkable market period. As far as I am concerned, my PTI possesses three great advantages for me and for my subscribers. (1) It is an emotionless index. It's based on market action, and my wishes or desires don't affect it an iota. (2) It's easy to follow. All you have to do is know up from down.

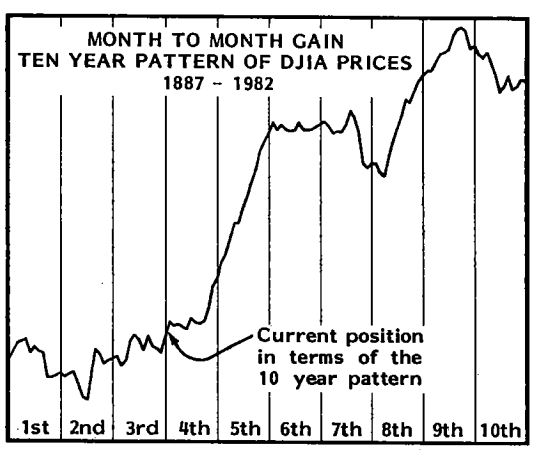
The PTI (see page 2 chart) recorded its bull market high of 1796 on November 29. It then dropped to a low of 1756 on December 23 and last week the PTI rallied to a high of 1786. So far, so good, as the PTI has been able to hold well above its 21-week moving average on all recent spates of weakness.

Note that the 21-week MA has tended to flatten out over the last month, and by the time you receive this Letter the 21-week MA will be at approximately 1760. Subscribers (and particularly new subscribers) should realize that the PTI, as well as being a trend-definer, is a "fail-safe" device. I would take any decisive penetration of the 21-week MA as a danger signal. A break by the PTI below the 21-week MA would call for a switch out of stocks and mutual funds into T-bills and money market funds. This, as I have explained many times in previous Letters, would be what I term "paying the cost of insurance."

On January 19 the NYSE announced that the January total short interest had dropped a mere 1.1% from 205 million shorts to 203 million. This is an extraordinarily small drop. The recent consensus was that there was a huge mass of shorts sold "against the box" and that the first week or so in 1984 would see these shorts covering. If so, it hasn't appeared in the figures. With all the supposed covering, the total short interest is still a mere 1% below its record December high.

For January the short interest ratio was 2.21. This is the fifth month in a row that the SIR has been above 2.10, a series never seen before in stock market history! I can only think that the stock market is building a massive technical base preparatory to a major (perhaps historic) move to the upside (see my Barron's article, December 26 for more on the SIR).

I don't know how many subscribers are familiar with the so-called Decennial Pattern. This pattern is based on the thesis that the market tends to repeat itself in increments of 10 (i.e., 1901 to 1910, 1911 to 1920, etc.). Growth Fund Guide (Box 6600, Rapid City, SD 57709) produced this chart showing the average month to month gains from 1887 to early 1982. The fourth, fifth and eighth year have been the strongest years with the fifth year (in this instance it would be 1985) stronger than either the fourth or the eighth (the fifth year of every decade since 1900 has been up!). Note that the sequence of the fourth and fifth



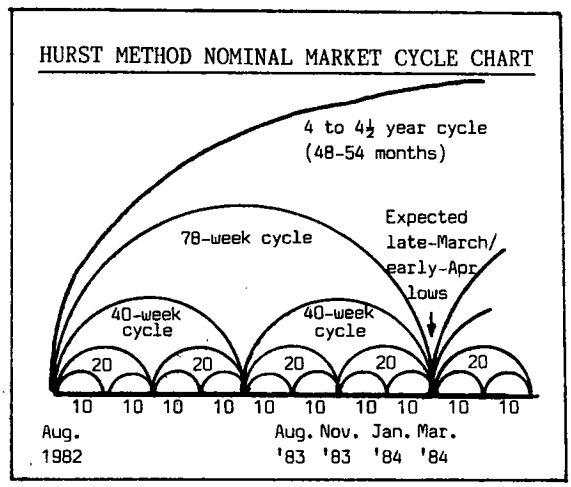
year (1984 plus 1985) has been the strongest two-year sequence in the Decennial Pattern. Item: where the fourth year in the decade was a Presidential election year, the two-year sequence of the fourth and fifth year was even stronger.

The Decennial Pattern will be particularly interesting over the next few years, and I say this because of the coming election. The conventional wisdom (based on the four-year "Presidential Cycle") is to "sell stocks" after the election. But this clashes in 1985 with the Decennial Pattern that indicates that the "5 years" have been the best years of the decade. So 1985 may be the year that the myriad followers of the election pattern may be crossed up. The "5th year" statistics are fascinating. For 1905 the Dow was up 38%, for 1915 Dow up 81%, 1925 Dow up 30%, 1935 Dow up 38%, 1945 Dow up 26%, 1955 Dow up 20%, 1965 Dow up 11%, 1975 Dow up 38%.

Do you remember my studies of the momentum index in Letter 869. At that time I noted that with the S & P 500 Index up over 50% from its year earlier level, we were seeing an upside momentum reading that had occurred only twice before since the 1920s. The last time we had a momentum reading over 50% was in May 1943. Following that upside explosion, the bull market reacted and consolidated until April 1944 (11 months later). Following April 1944 stocks roared up to a bull market high in early 1946.

So in Letter 869 I wondered whether the market wouldn't follow the same course. Remember, the momentum index hit its peak of 50% in July 1983. Therefore, I wrote in Letter 869 that it could be June 1984 (11 months later) before this market absorbs the tremendous upside compression and is ready to take off again on the upside.

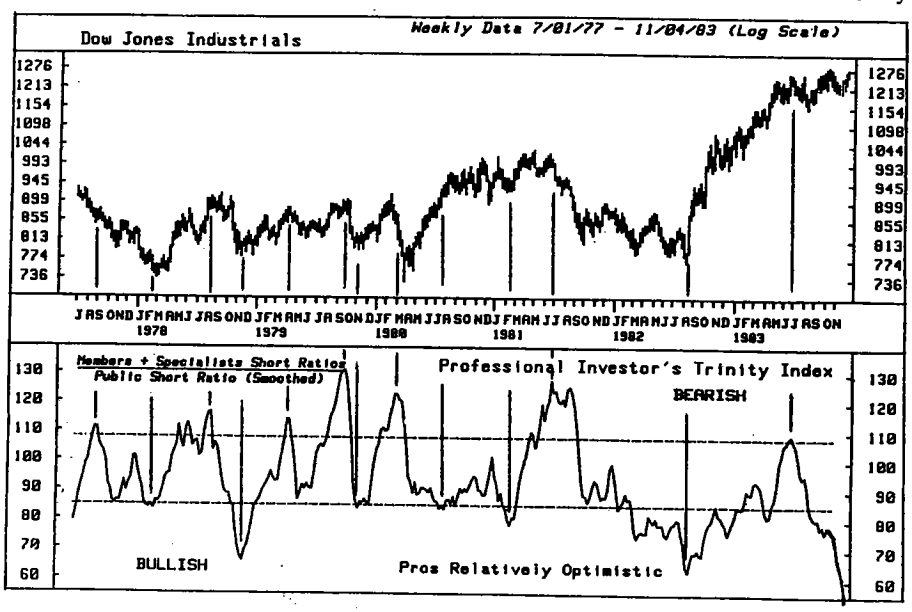
The action of the market so far certainly suggests that we could be seeing a technical repeat of the 1943-44 action. Along these lines I thought this chart by my friend Ken Gammage (Richland Report, PO Box 22, La Jolla CA 92038) was most interesting. Ken is a long-time student of the market cycles, and this chart appeared in his latest Letter. Here we see what Ken calls a "nesting of cycles" due to hit around late-March to early-April of 1984. That nesting would include the 10, 20, 40 and 78-week cycles. If that occurs, it would coincide pretty closely with the June 1984 "forecast" based on the 1943-44 momentum study.



TRINITY INDEX: Recently, for the first time since October 1974, the public was putting out more shorts than the NYSE specialists. This is so rare an occurrence that I wanted to go into it further. I commented in recent Letters about Bob Gross' so-called Trinity Index. This Index adds the NYSE member short ratio and the specialists short ratio and then divides the sum of the two ratios by the public short ratio. In other words, the Trinity Index shows us a ratio of astute shorting (specialists and members) to amateur or public shorting.

Ned Davis ran off a chart of the Trinity Index, and I have updated that chart. What the chart shows is clear enough. The Trinity Index has now dropped off the bottom of the chart, showing an extraordinary situation much like that which occurred during late-1978 and again in August 1982. The public thinks the market is a great short sale, while the professionals have curtailed their shorting dramatically (incidentally, I understand that Art Merrill of Technical Trends has taken the Trinity Index back 18 years and is impressed with its record. The Index proved particularly good for the forecasting 5 to 26 weeks into the future).

This situation would seem to dovetail closely with the equally extraordinary picture of the short interest ratio on the NYSE. There, as I have mentioned, we see the short interest ratio above 2.10 for five months in a row, a level never seen before.



On the face of it, there seems to be too much bearishness on the part of the public towards the stock market. My feeling is that somewhere ahead the sellers and the short sellers will be exhausted, and all the bad news (upon which they base their shorting) will be discounted by the market. When that point is reached the major trend of the stock market will reassert itself. And the major (primary) trend is up.

INVESTMENT POSITION: The bull is still in this box. He's resting (some say hiding), but he's there. I'm not

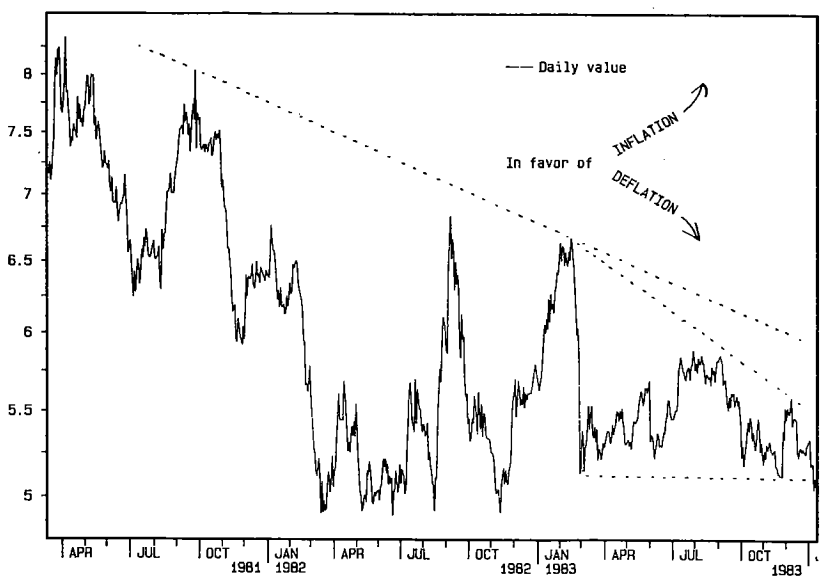
going to recommend any new purchases, but subscribers should hold on to all their stocks and mutual funds. During a bull market, TIME works for the bull. Which is another way of saying that values increase (through time) during the life of a bull market.

WHICH WAY? Here's a chart that I have run before. It's a ratio of two items that are extremely sensitive to the forces of inflation or deflation. The two items are gold and bonds. If inflation heats up, interest rates normally rise and bonds go down. By the same token, gold goes up in an inflationary environment. The converse is true during a deflationary situation.

What we see here is a picture of the forces of deflation and inflation meeting head-on. The "confrontation" has (technically) assumed the pattern of a large triangle on the chart. But the overall look of the picture is deflationary with the ratio declining ever since early-1981. More recently, since January 1983, the declining trend towards deflation has been steeper, as you can see by the steep descending trendline marked X on the chart.

It is important to realize that even though inflation (based on the producer price index) is now very low, bond rates are holding in a high range–and this is because of the massive debts and deficits in this nation. But despite this the ratio has been coming down. If yields were now coming down in harmony with disinflation, then this ratio would probably be at new lows.

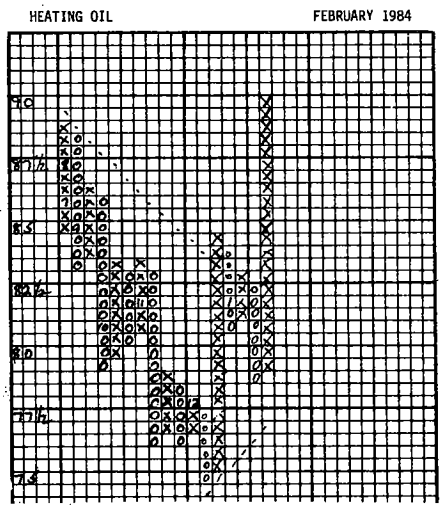
But on a cold reading of the chart, it is clear that the forces of deflation are winding out over the forces of inflation. This is a negative for gold, and ordinarily a big plus for bonds. But as I say, there is an added ingredient in the bond picture and that is that the bond market is wrestling with record deficits and debts.



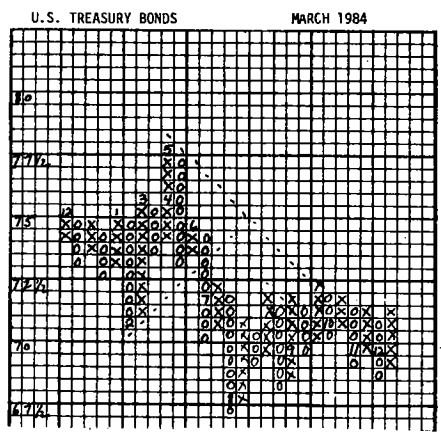
LONDON GOLD PM / U.S. TREASURY BOND, 8s 1996-01 Aug bid

WHAT'S GOING ON? The longer I'm in this business the more I think in terms of prices (and charts which simply graph a collection of prices). You can keep all the talk, you can keep all the forecasts and promises and warnings. Just give me the prices, and I'll do my own thinking.

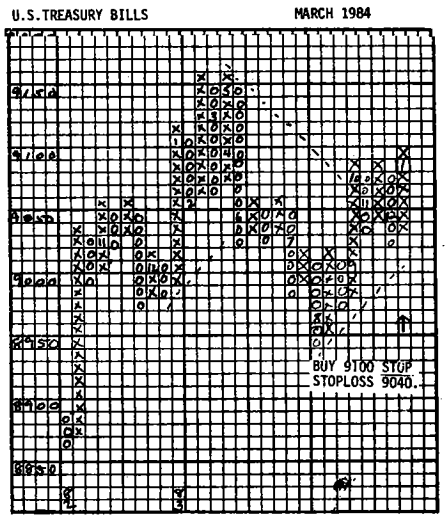
Speaking of prices, here are a couple of charts that I find fascinating. Everybody's talking about "weak oil prices" and how much lower oil is going to drop. Forget it. The people who talk weak oil haven't been looking at the prices. Here's a chart going back to last July, and what do we see? We see a strong basing pattern, the breakout, and heating oil now far above its low of 75 posted in December. In fact, oil is up around 18% above its December low and near its highest price of the last year!



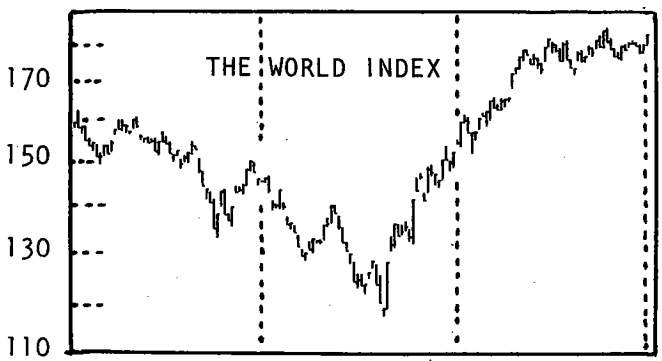
The second point & figure chart shows US Treasury bonds (March contract). This chart pattern looks like a base to me, and the "work" the T-bonds are doing is now on the bull side of the major declining trendline (dotted line). A price of 73 on the March contract would represent a major breakout in favor of higher bonds and lower interest rates.



In the meantime, the March T-bills (see chart pg. 5) have already broken strongly out of a base pattern. There is now a 3% yield spread in favor of the bonds over the bills, and this is a fat premium to pay for short-term money. So if the bills continue to rally (with lower yields) the pressure will be on the bonds to catch up to the bills. Everybody is "talking about" higher interest rates. But the prices on the bonds and bills are saying, "Maybe not, maybe rates are going lower!" (P & F charts courtesy of Chartcraft, Larchmont NY).



All primary trends are international in scope. Here is the World Index compiled by *Capital International Perspective* of Geneva, Switzerland. It includes the action of all the major stock markets of the world. Note that the Index is currently within a fraction of its all-time high. Recently stock markets in Britain, Japan, West Germany, France, Switzerland, the Netherlands, Denmark, Belgium and Norway have hit record highs. The US, in fact, is far behind most Free World markets. I expect us to catch up.



NOTES & QUOTES:

The argument rages, and letters are coming in thick and fast to the editorial pages of the various newspapers. And it's all about whether the current economic expansion is going to last the year or die out because of "lack of M-1." The most intelligent words on the subject (I think) appeared in Grant's *Interest Rate Observer,* a fine new publication written by Jim Grant (formerly a Barron's columnist), 233 B'way, NYC 10279.

Too many gods

Most voters are only just now focusing on the transition from recession to recovery. But economic theologians are already in full cry over the questionable prospects for sustained prosperity.

Monetarists charge that without a new burst of liquidity following five months of no growth in M-1, further recession can be expected by mid-year. Wage and commodity pessimists, on the other hand, envision sufficient final demand and capacity pressure to ensure 7% inflation soon, and perhaps 10% by late 1985.

For our money, neither outcome is likely, and we know a thing or two about the history of great nations. When the history of this republic is written, the monetarists will be proven wrong. At least, by the time the last revision is in, the numbers won't look so bad after all. And the wage and commodity bears will be proven wrong too. International pressures in oil, bank debt and the currency markets will continue to weigh on prices, for a while at least.

* *

I've written many times that there is only one guaranteed way to get rich and that is compounding the safest investment vehicles through time. A number of investment houses have separated T-bonds into two parts, the interest rate payments and the right to receive the face value of the bond at a stated time. Among the houses that offer these bonds are Merrill Lynch (they call them "Tigers"), Lehman ("Lions"), Salomon Bros. ("Cats"), Becker ("Cougars"). The interest on these bonds is taxable annually, but they are ideal for tax-deferred pension plans. Most of the bonds now yield near 12%, which means that you can buy a $100,000 T-bond maturing early in the next century for around $8000. The big advantage of these vehicles is that you do not have to worry about reinvesting your money each year at high interest rates. But remember, these bonds are best for younger people, who can plan on waiting 20 years for their money.

* *

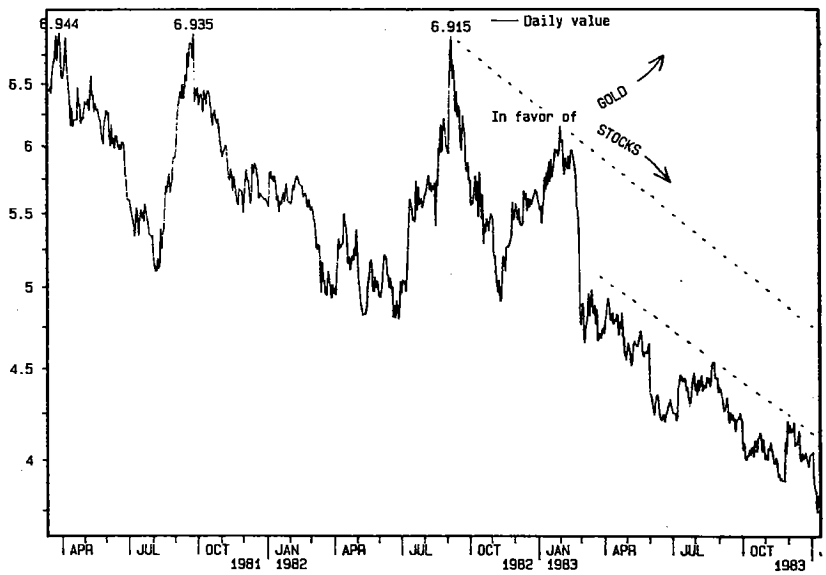
Our military (yours and mine) spends $1.2 billion a year on phones and phone service. They say the new phone break-up is going to present problems for the military (and I'm sure that's an understatement). Personally, I think the break-up of the phone company is one of the most ridiculous bureaucratic goofs in decades. And I'm not alone.

The Justice Department did no one any favors with its prosecution of the telephone companies split-up. Not only has telephone equipment taken a big jump in price and variety, but a call to the AT&T service number produces first a recorded voice telling the caller "your call will be taken in order," followed by a so-far undetermined number of rings—and no answer. On one occasion, the phone was allowed to ring 40 times, on another, 50 rings. With no real human on the other end. Maybe a post card is in order.

GOLD: There is one fundamental chart that I have followed for years, and that is the ratio of gold to the broad NYSE Index. Mr. John Carder of Colorado (a subscriber and computer expert) was kind enough to run this up-dated chart of gold for me. Here we see the subtle decline in the ratio peaks during 1981 to mid-1982, a decline in peaks in favor of common stocks.

From the 6.915 peak of mid-1982, the ratio tumbled, and during 1983 a new lower declining trendline traced the collapse of the gold-common stock ratio to its recent low.

What the chart is telling us is very simple. It is saying that the investor should be out of gold and in common stocks. But for the benefit of my hard money subscribers, you should also realize that when this ratio declines the background is negative for gold. I have observed over the years that the gold/common stock ratio (when viewed on a trend basis) is one of the best indicators for judging whether gold is in a bull or bear market.



LONDON GOLD PM / NYSE COMPOSITE AVERAGE

My feeling is that as long as this ratio is going down (as it now is) on a trend basis, holding gold is, at best, a tedious proposition and, at worst, a losing proposition.

Below is a long-term chart of gold, courtesy of Dunn & Hargitt. This is an arithmetic chart and on this chart the current gold price is still above its long-term trendline. On a ratio (semi-log) chart gold is now slightly below the long-term trendline which comes in at about 374. The argument which is occupying the mind of every hard money advocate is whether inflation is going to heat up later in 1984, or whether no-inflation is the wave of the future.

My own feeling is, "why guess?" The market will give us the answer when it's ready, and in the meantime gold buyers are "fishing" for a bottom. I don't particularly like bottom fishing, so I'll wait for more definitive word from the market itself. But with real interest rates at their highest level in modern history, it's expensive to hold gold. Thus we are witnessing the very unusual picture of high interest rates, low inflation and gold still in a major downtrend. In the past, high interest rates have been associated with high inflation, and rising gold. What keeps interest rates high in the low-inflationary atmosphere? Easy, it's the debt and the deficits. And I see only one solution that is workable here. I wrote about it in the last Letter, and that solution is a national sales tax. I might add that along with a national sales tax there would have to be a mandatory edict that would require all the money that came in from the national sales tax (and I mean ALL the money) to go towards reducing the deficit.

LATE NOTES: The PTI closed out the week at 1777, 20 points above the 21-week moving average. As of Jan. 20, the A-D was down 9 of the last 11 sessions. Thus, the market is working off an over bought condition. But with the breadth (A-D ratio) heavily on the downside during 1984 so far, it is significant that the greatest number of daily new lows (NYSE) was recorded on January 16th – 16 new lows. That's hardly downside pressure.

NEXT MAILING: Feb. 8